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Supreme Court, U.S.
FILED
FEB 14 2003
CLERK

No. 02-42

In The Supreme Court of the United States

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Petitioner,

v.

GILBERT P. HYATT AND EIGHTH JUDICIAL DISTRICT COURT OF THE STATE OF NEVADA,

Respondents.

On Writ Of Certiorari To The Supreme Court Of The State Of Nevada

REPLY BRIEF OF PETITIONER

BILL LOCKYER
Attorney General of the State of California
MANUEL M. MEDEIROS
State Solicitor
ANDREA LYNN HOCH
Chief Assistant Attorney General
DAVID S. CHANEY
Senior Assistant Attorney General
WM. DEAN FREEMAN
Lead Supervising Deputy Attorney General
FELIX E. LEATHERWOOD
Deputy Attorney General
Counsel of Record
300 South Spring Street, # 500N
Los Angeles, California 90013-1204
Telephone: (213) 897-2478
Fax: (213) 897-5775

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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ARGUMENT

Respondent Hyatt seeks to minimize the extraordinary challenge to cooperative federalism that is presented by this dispute. It bears remembering that this case is about a former California resident who moves to Nevada and then uses the *Nevada* courts to pass judgment on *California's* decision to tax him for his *California* income.[1]

In this Court, petitioner Franchise Tax Board has urged that existing conflicts-of-law methodology is inadequate to address the question of the extent to which the Full Faith and Credit Clause requires Nevada courts to apply California's Government Code section 860.2. The Board argues that existing methodology defers to the *interests* of the forum State over the non-forum State, without regard for the *effects* of the choice of law on the

[1] The BRIEF FOR RESPONDENT GILBERT P. HYATT [Resp. Br.] contains too many factual errors to list; however, some of the more egregious bear mention. For example, Hyatt has alleged that the audit and decisions to issue the NPAs were motivated by the religious prejudice of the third auditor; however, the decision to audit Hyatt was made in 1993, by the first auditor. Record at Vol. 3, # 11, Cox Aff. ¶ 3. Moreover, no auditor made the decision to issue the NPAs; other Board personnel made those decisions after reviewing the final audit report. Record at Vol. 3, # 11, Bauche Aff. ¶¶ 4 and 6. It is also worth noting that in the first proceedings before the Nevada Supreme Court Hyatt accused the Board of "snoop[ing] at mail on the doorstep and record[ing] the timing, description, and quantity of his trash." Record at Vol. 6, # 28, p. 10, lines 10-12. After the Nevada Supreme Court originally granted the Board's writ and found that the Board's "investigative acts were in line with a standard investigation to determine residency status for taxation pursuant to its statutory authority" (Cert. App. 42-43), Hyatt increased the level of accusations, claiming instead that the Board's auditor "looked through his mail and his trash." Resp. Br. at 4. These two examples alone illustrate that Hyatt appears willing to claim (or allege) anything in order to breathe life into his lawsuit.

non-forum State. Such an approach is constitutionally adequate in dealing with suits over traffic accidents caused by agents of the non-forum State while driving in the forum State. *Nevada v. Hall*, 440 U.S. 410 (1979). It is wholly inadequate to deal with suits about official conduct by agents of the non-forum State carried out in the non-forum State and in the forum State in implementation of a core governmental function such as collection of tax debts owed by the plaintiff to the non-forum State.

The Board accordingly urges adoption of a different choice-of-law rule, to apply when suit is brought against the non-forum State or its agents based on activities in implementation of a core governmental function of the non-forum State. Such a rule – based as it is on the potential for interference by the forum State with the non-forum State's capacity to fulfill its own sovereign responsibilities (*see Nevada v. Hall*, 440 U.S. at 424 n.24) – would refer, not to the forum State's *interest* in the choice of law, but rather to the *effects* of the choice on the non-forum State's ability to function as a co-equal sovereign government. It would, in short, require the forum State to give full faith and credit to the non-forum State's own statutes limiting liability for injuries caused by the core sovereign activities that are the subject of the litigation.

A. When the effect of the forum State's policy preference is interference with the defendant State's capacity to function as a co-equal sovereign, a superficial consideration of the forum State's legislative competence will not suffice to dispose of the choice-of-law issue.

Hyatt's argument proceeds from a faulty premise. Hyatt first observes that, in resolving a choice-of-law

question, the Full Faith and Credit Clause allows a State to apply its own law to a subject matter about which it is competent to legislate – a proposition with which the Board generally has no dispute. *See Sun Oil Co. v. Wortman*, 486 U.S. 717, 721 (1988), citing *Pacific Employers Ins. Co. v. Industrial Accident Comm'n*, 306 U.S. 493, 501 (1939). Hyatt next asserts that "[t]he central full faith and credit question, then, is whether Nevada was 'competent to legislate' regarding torts that are the subject matter of this lawsuit." Resp. Br. at 16.

But this Court has never suggested that the inquiry over a forum State's prerogative to ignore a defendant-State's statutory liability limits is merely a matter of confirming the forum State's legislative competency over the conduct giving rise to the alleged liability. It is clear, for example, that in *Nevada v. Hall*, this Court accepted California's rejection of Nevada's liability limitations, not only because California's choice of law rested on a legitimate policy preference about matters over which California has undisputed legislative competency, 440 U.S. at 424, but more importantly, because California's choice did not threaten to interfere with Nevada's capacity to fulfill its own sovereign responsibilities. *See* 440 U.S. at 424 n.24. Hyatt's assertion that Nevada enjoys legislative competency to enact and enforce its tort law does not end the inquiry; at best, it would be merely a beginning.

In any event, it is facetious for Hyatt to argue that nothing is at issue here other than Nevada's legislative competence to define the respective rights and liabilities of persons in their interpersonal interactions. The "person" before the Nevada court as a defendant is, after all, a co-equal sovereign State, and the "interaction" at issue is nothing less than the sister-State's effort to investigate a

possibly fraudulent evasion of tax obligations by the plaintiff based on his prior residency in the defendant State. To be sure, Hyatt's allegations may sound in tort, but those vague allegations *patently* concern the conduct of the critical governmental function of investigating, assessing, and collecting taxes from a delinquent taxpayer – hardly the subject of tort jurisprudence.

What is really at issue here is not mere adjudication of alleged torts, but rather Hyatt's effort to have the Nevada courts supervise and pass judgment upon the manner in which California's taxing agency investigates whether Hyatt has evaded his tax obligation to California.

B. Contrary to Hyatt's assertion, the Board does not seek a cession of *Nevada's* legislative jurisdiction over torts. Rather, the Board seeks an end to Nevada's usurpation of *California's* legislative jurisdiction to limit the kinds of remedies that California taxpayers have to challenge a tax investigation and audit.

Hyatt argues at great length that the Board's proposed rule is inconsistent with full faith and credit history and principles, that it "would strip away significant legislative authority from the forum States," Resp. Br. at 21, and that it suggests that, in the Full Faith and Credit Clause, "the States were permanently ceding to each other part of their traditional, jealously guarded legislative authority." Resp. Br. at 26. The argument rests entirely on Hyatt's own baseless contention that the "legislative authority" truly in question is Nevada's authority to legislate *tort laws*.

The Board does not take issue with Hyatt's lengthy argument to the effect that the Full Faith and Credit Clause was never intended to work a cession of legislative jurisdiction by the States *inter se*. But the argument misses the point. This case is not about compelling a *cession* of the forum-State's legislative sovereignty; it is rather about *usurpation* of the defendant-State's legislative sovereignty.

In order effectively to carry out investigation, assessment, and collection of delinquent taxes, California has deliberately immunized its tax officials from liability for alleged injury caused by acts incidental to the assessment or collection of taxes. Specifically, California Government Code § 860.2 provides that "Neither a public entity nor a public employee is liable for an injury caused by: (a) Instituting any judicial or administrative proceeding or action for or incidental to the assessment or collection of a tax [or] (b) An act or omission in the interpretation or application of any law relating to a tax."[2]

This is not to say that California taxpayers have no means to challenge what they believe to be an unwarranted investigation or assessment. Indeed, a California taxpayer, including Hyatt, has all of the following remedies for challenging an audit investigation: (1) a complete review of the tax assessment at the protest stage,[3] (2) an

[2] The statute has been broadly construed by California courts. *Mitchell v. Franchise Tax Board*, 183 Cal.App.3d 1133, 1136, 228 Cal.Rptr. 750 (1986) (statute bars suit for alleged interference with business and credit, slander to title, denial of due process, and punitive damages based on allegedly willful, wanton and malicious behavior).

[3] Cal. Rev. & Tax Code §§ 19041, 19044.

independent administrative review by the five-member State Board of Equalization,[4] (3) a taxpayer's cause of action for a tax agency's failure to follow published procedures,[5] and (4) a de novo judicial review of administrative tax determinations of California residency without the necessity of prepaying the tax.[6]

What an individual taxpayer may not do, however, is sue the Board on the ground that the investigation is injurious – at least such a suit may not be brought in California courts. What Hyatt wants is the right to move to Nevada and sue the Board *there*. The net effect of Nevada's willingness to entertain Hyatt's suit against the Board is nothing short of an usurpation by the Nevada courts of *California's* legislative jurisdiction to limit the kinds of remedies that California taxpayers have to challenge a tax investigation and audit.

C. Hyatt's proffered "contacts" purporting to support Nevada's choice of law are manifestly insufficient as a basis for a choice-of-law decision that results in litigation that interferes with California's capacity to carry out an essential governmental function.

Hyatt acknowledges that Nevada's choice of its own immunity policy over California's statutory liability limits must be based on "a significant contact or significant aggregation of contacts, creating state interests, such that

[4] Cal. Rev. & Tax Code §§ 19045-47.

[5] Cal. Rev. & Tax Code § 21021.

[6] Cal. Rev. & Tax Code § 19381; Cal. Civ. Proc. Code § 1060.5.

choice of law is neither arbitrary nor fundamentally unfair." Resp. Br. at 17. Hyatt asserts that such contacts are present here, but the contacts in this case manifestly cannot justify Nevada's intrusion into California's administration of California taxes.

1. Hyatt's residency in Nevada cannot reasonably justify that State's interference with California's tax collection efforts, because it is precisely Hyatt's move to Nevada that prompted the tax audit in the first instance.

First, Hyatt erroneously asserts as a sufficient "contact" that "Nevada is the State in which the plaintiff suffered his injuries." *Id.* But, as a threshold matter, a plaintiff's residence and place of filing the action are generally accorded little or no significance in the constitutional analysis because of the danger of forum shopping. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 820 (1985). Fairness and reasonable expectation of the parties are more important to the analysis. *Id.* at 822. In this case, both fairness and reasonable expectation favor California. Fairness, because only 3% of the activities occurred in Nevada. JA at 237. Reasonable expectation, because: (1) Hyatt was a long-time resident of California, where he worked for many years developing the computer technology that resulted in his receipt of $40 million in income in late 1991 (JA at 48); (2) Hyatt claimed he terminated his California residency just before receipt of that $40 million; and (3) given the suspicious circumstances, Hyatt had every reason to expect that his non-residency claim would be investigated by California agents enforcing California law.

Furthermore, the facts of this case dramatically confirm this Court's concern that reliance on residency as a justification for choice-of-law invites forum shopping. Indeed, it is Hyatt's evident position that this Court's full faith and credit jurisprudence guarantees Nevada's prerogative to serve as a sanctuary for "tax refugees" from California who, solely by virtue of moving (or claiming to have moved) their residence across the state line, may not only avoid the payment of future California income taxes, but may also acquire the standing to sue their former State in Nevada to impede the collection of past taxes due and owing.

2. Even if it existed, Nevada's official hostility to California tax practices would not justify an assertion of the prerogative to supervise the California taxing agency in those practices.

Hyatt asserts as a substantial "contact" the fact that the Board "deliberately took actions that either occurred in Nevada or were specifically intended to have their harmful effects there." Resp. Br. at 19. Hyatt also avers that Nevada may be concerned about "targeting" of Nevada residents by California tax officials. *See* Resp. Br. at 18. In effect, Hyatt suggests that Nevada's hostility to California tax practices would justify Nevada's assertion of judicial supervision over the California taxing agency.

Of course, the State of Nevada is not before the Court. Nor has Nevada itself chosen to appear as amicus curiae to support Hyatt's use of its courts.

In any event, the law is quite contrary to Hyatt's view. Nearly a half-century ago, the Court recognized that full faith and credit would be properly invoked to restrain "any

policy of hostility to the public Acts [of another state]." *Carroll v. Lanza,* 349 U.S. 408, 413 (1955). And, as Justice Stevens noted in his concurring opinion in *Allstate Insurance Co. v. Hague*, 449 U.S. 302, 323 n.10 (1981), in *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980), the plurality opinion described the purpose of the Full Faith and Credit Clause as the prevention of "parochial entrenchment on the interests of other States."

Of course the Board deliberately took actions in Nevada, and of course the Board took actions in California with the intent of effecting a result in Nevada. Hyatt, himself, brought about the tax audit by moving *to Nevada*. If Hyatt fails to cooperate with California tax officials in *California*, then those officials obviously have little alternative but to follow his trail into *Nevada* or forego collection of taxes due and owing. Hyatt's preferences to the contrary notwithstanding, there is no evidence of any official objection by the State of Nevada to California's tax investigations in Nevada, much less of the Board's investigation of Hyatt in particular. And even if there were, such an objection would not be a constitutionally sufficient basis for Nevada's refusal to give full faith and credit to California's statutory structure for its tax collection processes. There are other, more appropriate means for addressing such political issues, e.g., interstate compact negotiations.

D. Hyatt is less than candid in suggesting that California's tax-collection efforts are unaffected by the proceedings in the Nevada courts.

Hyatt makes the misleading assertion that "despite the Nevada litigation, the tax proceeding against respondent is continuing without interruption in California."

Resp. Br. at 10. While the Board will concede that it is attempting to press forward with its investigation despite Hyatt's effort to hamper and derail that investigation, that is hardly the whole of the picture.

The Nevada litigation interferes with the California tax process, first and foremost, by chilling the activities of the Board's auditors and investigators. Because the Nevada courts have resolved to inquire into the whole of California's tax assessment and auditing process (JA at 137-138), every action taken by every Board employee in furtherance of the investigation against Hyatt threatens to become the subject of additional discovery and additional alleged injury.

The interference is analogous to that described in *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100 (1981), wherein this Court held that taxpayers could not sue for damages under 42 U.S.C. § 1983, based upon a property tax assessment. The Court's explanation that a suit for damages "would 'in every practical sense operate to suspend collection of state taxes,'" *ibid.*, fully recognizes that a suit for money damages amounts to a collateral attack on the taxing process. The Court observed:

> Thus, a judicial determination of official liability for the acts complained of, even though necessarily based upon a finding of bad faith, would have an undeniable chilling effect upon the actions of all County officers governed by the same practicalities or required to implement the same policies. There is little doubt that such officials, faced with the prospect of personal liability to numerous taxpayers, not to mention the assessment of attorney's fees under 42 U.S.C. § 1988, would promptly cease the conduct found to have

> infringed petitioners' constitutional rights, whether or not those officials were acting in good faith. In short, petitioners' action would "in every practical sense operate to suspend collection of the state taxes . . . ," *Great Lakes*, 319 U. S., at 299, a form of federal-court interference previously rejected by this Court on principles of federalism.

454 U.S. at 115. No lesser chilling effect results from Hyatt's sweeping action for damages in the Nevada courts.

Furthermore, the Nevada courts' refusal to dismiss Hyatt's tort action has placed the Board in the untenable position of having to comply with outrageous discovery demands or risk sanction of its attorneys and default judgment against the State. And indeed, discovery has been oppressive. Hyatt's trial attorneys have taken 315 hours of deposition testimony from 24 witnesses, have made 329 separate document demands from the Board (which have produced over 17,000 pages of documents), and have made 340 additional document demands to deposed witnesses. Record at Vol. 3, # 11, Ex. 8, pp. 420-422. It is disingenuous for Hyatt to suggest that the Board's tax proceedings in California have not been adversely affected by having to make employees available for depositions and by having to spend hundreds of hours of employee-time marshaling documents for response to document-production demands in the Nevada courts.

Finally, as a direct result of Hyatt's Nevada litigation, the administrative tax process in California has been effectively placed on hold, despite the Board's efforts to

advance it.[7] Specifically, complying with the protective order of the Nevada court, the Board subpoenaed documents and deposition testimony relevant to Hyatt's claims. App. 8. Then, again complying with the protective order of the Nevada court, the Board attempted to enforce the subpoena duces tecum in Sacramento Superior Court, an attempt which Hyatt has opposed by filing his Opposition to Subpoena. App. 1-27. Remarkably, Hyatt has opposed the Board's subpoena on the grounds that California courts must extend full faith and credit to the Nevada protective order, and must accordingly block the Board's access to the relevant tax information.[8] Hyatt's actions in opposing the Board's subpoenas have impeded the progress of the administrative proceedings and are directly contrary to the statements that he makes in his brief filed in this Court, where he claims that "despite the Nevada litigation, the tax proceeding against respondent is continuing without interruption in California." Resp. Br. at 10. The matter is still under submission before the California courts at this time.

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[7] In order to illustrate that Hyatt – despite his contrary representations to this Court – is using the Nevada lawsuit to interfere with the administrative tax proceedings pending in California, the Board has attached the following document as an appendix to this brief:

App. 1-27: Respondent Gilbert P. Hyatt's Response and Opposition to the OSC re FTB's Petition for Order to Compel Compliance with Administrative Subpoena (hereafter referred to as "Opposition to Subpoena").

[8] Hyatt argued that the court in California must accord the protective order full faith and credit, claiming that: "under the Full Faith and Credit Clause, the Nevada protective order is entitled to all the respect and solemnity of any other judicial ruling from a sister state or another California court[.]" App. 26-27.

E. The rule urged by the Board is reasonable, workable, and limited in scope.

This Court's expression of concern in *Nevada v. Hall* has directly led to the following rule as urged by the Board:

> A forum State may not refuse to extend full faith and credit to the legislatively immunized acts of a sister State when such a refusal interferes with the sister State's capacity to fulfill its own core sovereign responsibilities.

Cf., *Nevada v. Hall*, 440 U.S. at 424 n.24.

1. If the rule can be said to involve a "balancing of interests," it is a balancing, not of the parochial interests of one State against those of another, but rather a balancing of the parochial interests of one State against a national, constitutional interest in cooperative federalism.

Hyatt complains that the Board's rule is merely a return to a discredited "balancing of interests" methodology for resolving choice-of-law issues. It is not. Whereas the former balancing-of-interests analysis balanced the interests of the forum State against the interest of the non-forum State,[9] the Board's rule reflects a balancing of the interests

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[9] *See Alaska Packers Ass'n v. Industrial Accident Commission of California*, 294 U.S. 532, 547 (1935).

of the forum-State against the interest of the Union, reflected in a system of cooperative federalism.[10]

Thus, the Board has repeatedly pointed out that its test looks to the *effect* of the choice-of-law decision on the capacity of the defendant State to carry out core sovereign responsibilities. Where, as was the case in *Nevada v. Hall*, the forum State's policy preference can reasonably be said to work no interference with the defendant State's basic capacity to function as a co-equal sovereign, that preference does not offend the mandate of the Full Faith and Credit Clause. But where, as in the instant case, the forum State's policy preference impedes critical tax collection efforts of a co-equal sovereign State, then the Board's rule would require that the parochial interests of the forum State yield to the constitutionally contemplated system of co-equal sovereign States.

The application of this rule prevents a forum State from assuming through its judicial system what amounts to a supervisory role over a sister State's core governmental functions. The rule requires nothing more than that State courts extend full faith and credit to the scope of scrutiny permitted by the acting State in the conduct of its

[10] However, that balancing occurred in the formulation of the rule, not in the application. No consideration is given the interests of the forum State in the application of the rule because, once the rule's elements have been met, the forum State must give "faith" to its sister State's conduct in carrying out its own core governmental functions; cooperative federalism requires no less. In the last analysis, there are certain state functions whose operation falls entirely within the acting State's responsibility. Legislative acts structuring those core sovereign responsibilities are entitled to truly *full* faith and credit under the Full Faith and Credit Clause.

core governmental functions. If the acting State has constitutionally valid immunity statutes that prevent its own courts from interfering in the governmental process, then the forum State must respect that limitation.

2. The Board's new rule has standards sufficiently well-described to enable courts to apply it.

Hyatt claims that the Board's rule is essentially standardless. While the Board acknowledges that there is no bright-line test for a "core governmental responsibility," it is not standardless because States would be able to identify such a responsibility by reference to their own essential operations. All States, for example, collect revenue by one device or another. The assessment and collection of state personal income taxes are the lifeblood of the California government because it is the means by which government is able to function.

That taxes are clearly a core function is supported by ample authority. For example, the ability of the State to assess and collect taxes is so important that the California Constitution bars "any court" from issuing a "legal or equitable process . . . to prevent or enjoin the collection of any tax." Cal. Const., art. XIII, § 32. Federal law similarly mandates that federal district courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341. In fact, as pointed out earlier, this Court has held that "taxpayers are barred by the principle of comity from asserting § 1983 actions against the validity of state tax systems in federal court." *Fair Assessment*, *supra*, 454 U.S. at 116. And, in a similar vein, this Court

has recognized "the vital interest of the government in acquiring its lifeblood, revenue" (*Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 21 (2000)) in holding that – despite bankruptcy statutes to the contrary – a debtor bears the burden of proof on a tax claim in bankruptcy court when the substantive law creating the tax obligation puts the burden on the taxpayer.

Although these authorities do not define a "core" sovereign process, they clearly illustrate that tax systems and processes are core. Here, the determination of residency is a foundational step in the collection of state personal income taxes. No State can effectively carry out its tax administration without being able freely to review and investigate a taxpayer's claims, even when they involve a claimed change of residency.

Likewise, all States exercise their law enforcement powers for the preservation of the health, safety, and welfare of their citizens. It is reasonable to characterize tax assessment and collection and law enforcement as core governmental functions, while the same may not be true for recruiting for a state university football team. The difficulty of drawing a bright line is less important than assuring that all processes that clearly are core are protected under the Full Faith and Credit Clause.

In addition, hypothetical difficulties in applying the rule are insignificant when compared to the harm to cooperative federalism – protected by the Full Faith and Credit Clause – that will occur if the Board's rule (or one having the same effect) is not adopted. As explained above, Hyatt's lawsuit is not limited to acts in Nevada, but intrudes into all aspects of California's decisions and actions in auditing Hyatt and assessing taxes against him.

Finally, despite the absence of a bright-line test, this Court has made similar types of determinations in various other settings. For example, in *Idaho v. Coeur d'Alene Tribe of Idaho*, 521 U.S. 261 (1977), a five-member majority of this Court held that the Coeur d'Alene tribe could not employ the *Ex parte Young*, 209 U.S. 123 (1908) exception to the Eleventh Amendment in a suit against the State of Idaho because the subject matter of the suit (ownership of the submerged lands and beds of Lake Coeur d'Alene) implicated Idaho's "special sovereignty interests," despite the fact that no attempt was made to *define* the term. *Id.* at 281, 287-288. And, in *Maine v. Taylor*, 477 U.S. 131 (1985), the Court held that Maine's statutory ban on the importation of live baitfish did not unconstitutionally burden interstate commerce, in part because the ban "serves *legitimate local purposes*[.]" *Id.* at 151 (emphasis added). In each of these cases, the court employed the test without attempting to define the universe of situations that would come within it. Likewise, here, the core-sovereign-function test is workable without having to describe every circumstance in which it might apply.

3. This Court did not reject the Board's proposed rule in *Bonaparte v. Tax Court*.

Hyatt also claims that the Board's rule has been impliedly rejected by this Court in *Bonaparte v. Tax Court*, 104 U.S. 592 (1881), a case that rejected the argument that full faith and credit barred a State from taxing the obligation of another State. According to Hyatt, *Bonaparte* involved "'interference' with 'core sovereign responsibilities,'" and since full faith and credit did not bar that, it should not bar Nevada's refusal here to apply California law. However, *Bonaparte* did not involve a lawsuit against

a defendant State that had raised the issue of applying its own immunity statute. Moreover, it only resulted in trimming a benefit to the non-forum State, it did not involve the type of interference with the tax *process* that exists in this case.

4. The Board's new rule is necessary.

Hyatt asserts that the Board's rule is unnecessary because of the protection already afforded to sister State defendants through comity, interstate compacts, and Congressional action. Any notion that a new rule is unnecessary because of comity, interstate compacts, and Congressional action is put to rest by the fact that this case is ongoing. Moreover, a new rule is necessary because current choice-of-law methodology does not remotely contemplate the cynical use of a State's judicial processes by a plaintiff against his former State of citizenship, to interfere with an ongoing governmental investigation of the plaintiff by the defendant State – especially when that investigation concerns tax obligations that were incurred during the time of plaintiff's former citizenship. In such a context, it is obviously insufficient simply to look at the face of the complaint and consider whether the forum State is competent to legislate in the general area of law encompassed by the allegations. Such an approach ignores the inescapable fact that plaintiff seeks to elevate the status of the forum court to that of a judge over the governmental investigation that is being conducted against plaintiff by the defendant sister State.

Furthermore, the Board's rule is necessary because this case cries out for full faith and credit protection. There must be a solution other than mere reliance on a

forum State's willingness to grant comity, because – as this case shows – comity is no solution. Both the type and amount of interference that the Board has detailed above illustrate that Nevada's refusal to extend full faith and credit has resulted in exactly the evils that Justice Stevens commented on in his concurring opinion in *Allstate*, where he explained that the Full Faith and Credit Clause "would be invoked to restrain 'any policy of hostility to the public Acts' of another State," and would prevent the "parochial entrenchment on the interests of other States." *Allstate Insurance Co. v. Hague*, *supra*, 449 U.S. at 323 n.10 (Stevens, J., concurring).[11]

[11] This Court held long ago that " . . . no state can be said to have a legitimate policy against payment of its neighbor's taxes, the obligation of which has been judicially established by courts to whose judgments in practically every other instance it must give full faith and credit." *Milwaukee County v. M.E. White Co.*, 296 U.S 268, 277 (1935).

CONCLUSION

Based on the foregoing reasons, Petitioner respectfully requests that this Court reverse the order of the Nevada Supreme Court.

Respectfully submitted,

BILL LOCKYER
Attorney General of the
State of California
MANUEL M. MEDEIROS
State Solicitor
ANDREA LYNN HOCH
Chief Assistant Attorney General
DAVID S. CHANEY
Senior Assistant Attorney General
WM. DEAN FREEMAN
Lead Supervising Deputy
Attorney General
FELIX E. LEATHERWOOD
Deputy Attorney General
Counsel of Record
300 South Spring Street, # 500N
Los Angeles, California 90013-1204
Telephone: (213) 897-2478
Fax: (213) 897-5775

Donald J. Kula, Esq. (SBN 144342)
RIORDAN & McKENZIE
A Professional Law Corporation
300 South Grand Avenue, 29th Floor
Los Angeles, California 90071-3109
Telephone: (213) 629-4824
Facsimile: (213) 229-8550

Eric J. Coffill, Esq. (SBN 84044)
MORRISON & FOERSTER LLP
400 Capitol Mall, Suite 2600
Sacramento, CA 95814
Tel: (916) 325-1324
Fax: (916) 448-3222

Attorneys for Respondent, GILBERT P. HYATT

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

IN THE MATTER GILBERT P. HYATT CALIFORNIA FRANCHISE TAX BOARD, Petitioner, vs. GILBERT P. HYATT, Respondent.	**CASE NO. 02CS01582** **RESPONDENT GILBERT P. HYATT'S RESPONSE AND OPPOSITION TO THE OSC RE FTB'S PETITION FOR ORDER TO COMPEL COMPLIANCE WITH ADMINISTRATIVE SUBPOENA** **[Declaration of Donald J. Kula in Support of Respondent Gilbert P. Hyatt's Response And Opposition To The OSC Re the FTB's Petition For Order To Compel Compliance With Administrative Subpoena filed concurrently herewith]**

Date: December 16, 2002
Time: 9:00 A.M.
Dept.: 54

Petition Filed: 10/11/02

Filed Under Seal Pursuant to Court Order of November 6, 2002

(Filed Nov. 26, 2002)

THIS DOCUMENT IS FILED UNDER SEAL AND IS NOT TO BE OPENED OR THE CONTENTS THEREOF DISPLAYED OR REVEALED EXCEPT BY ORDER OF THE COURT

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Respondent Gilbert P. Hyatt hereby submits his response and written opposition to the Court's OSC Re Petitioner California Franchise Tax Board's (the "FTB") Petition for Order to Compel Compliance with Administrative Subpoenas.

I. Issues Presented.

To be enforceable, an administrative subpoena must seek information relevant to the agency's investigation and cannot be too indefinite. Here, the FTB's administrative subpoena from the underlying tax proceedings provides no specificity but rather requests *all* materials from a separate tort case in Nevada. In the underlying tax proceedings, the sole issue is Hyatt's residency in Nevada during a short six month period between September 1991 and April 1992. In the Nevada tort case, at issue is the FTB's later misconduct during its residency audits of Hyatt starting in mid-1993.

Should the Court deny the FTB's petition because the FTB's subpoena is too indefinite and seeks information not relevant to its investigation of Hyatt?

Given the FTB's past threats and current request for irrelevant information about Hyatt, does the subpoena amount to an abuse of process by the FTB?

II. Summary of argument.

Relevance and definitiveness. Taken literally, the FTB's administrative subpoena could be interpreted to include *all* existing and future discovery produced in the Nevada tort case, including that produced under a protective order issued by the Nevada court, all present and future sealed Nevada court filings, and maybe even the privileged or otherwise objectionable materials appropriately withheld by Hyatt in the Nevada tort case. If read in that light, the subpoena is indisputably too broad, too indefinite, and seeks obviously irrelevant material for the tax proceedings. But even a more narrow reading of the FTB's subpoena that would limit the documents sought to those designated by Hyatt under the Nevada protective order does not sufficiently identify the documents requested nor explain their relevance to the tax proceedings.

In response to the subpoena, Hyatt twice asked the FTB before it filed its petition to specify which documents it seeks for the tax proceedings and why they are relevant to the tax proceedings.[1] The FTB ignored both requests. Again, the California tax proceedings and the Nevada tort case involve very different issues and distinctively

[1] *See* M. Hutchison letter, dated June 10, 2002, attached as Exh. C to declaration of Robert Dunn submitted with the FTB petition, and E. Coffill letter, dated July 22, 2002, attached as Exh. A to declaration of Benjamin F. Miller submitted with the FTB petition.

different time periods. The FTB cannot in good faith assert to the contrary, nor has it even attempted to explain how any of the documents specially designated under the protective order from the Nevada tort case have any relevance to the California tax proceedings.[2]

Prior threats/abuse of process. The administrative subpoena was issued by the FTB shortly after it lost a motion in the Nevada case seeking to vacate the protective order. In denying the motion, the Nevada court determined without ambiguity that the protective order is limited in scope and applied to only a small subset of specially designated documents. The FTB's attempt to convey something to the contrary to this Court is misleading and masks its motive for seeking an unnecessarily broad order from this Court. The requested order would make the Nevada protective order a virtual nullity, thereby allowing the FTB to use and disclose the protected materials from the Nevada tort case in any manner it chooses. The FTB has previously threatened to make Hyatt's confidential materials public if he did not agree to settle the tax case.

This is an obvious concern to Hyatt. Before, during, and after the FTB audits of Hyatt, the FTB has declared its intent "to get" Hyatt, threatened the public disclosure of his confidential information if he did not settle, threatened to seek much more of his confidential information if

[2] As set forth below and in the accompanying Declaration of Donald J. Kula, Hyatt has already produced to the FTB in the tax proceedings the relevant information that was designated under the protective order. Materials directly produced in the tax proceedings can be used therein.

he did not settle, threatened to and did surveil him during the Nevada case, and has already in this proceeding temporarily disclosed some of Hyatt's confidential tax information. The administrative subpoena and the relief sought through its current petition are, unfortunately, consistent with the FTB's prior threats to Hyatt.

In sum the FTB stated at the outset of the Nevada tort case that the two proceedings were separate, and that one would not interfere with the other.[3] The FTB now requests something very different from this Court without explaining why "all" materials from the tort case are needed in the tax proceedings. Because the FTB's administrative subpoena is indefinite, seeks documents not relevant to the tax proceedings, and amounts to a manifestation of the FTB's prior threats, good cause exists for the Court to deny the FTB's petition.

III. Statement of the case

A. The tax proceedings have a limited focus: Hyatt's Nevada residency between September 1991 and April 1992.

The FTB's administrative subpoena was issued in relation to tax proceedings the FTB commenced against Hyatt almost 10 years ago, but for which a final determination has yet to be issued by the FTB. The sole issue in the tax proceedings is whether Hyatt became a permanent resident of Nevada in September of 1991 as he contends, or in April of 1992 as the FTB contends. In short, there is

[3] Affidavit of T. Collins, dated March 18, 1998, attached as Exh. A to the Declaration of Donald J. Kula ("Kula Decl.")

a six month period in dispute, and the issue is limited to where Hyatt resided during that time period. A detailed presentation of Hyatt's position, the overwhelming evidence in his favor, and a rebuttal to the Declaration of Bauche (with Exhibits), is set forth in his supplemental protest letter for the 1991 tax year submitted as an exhibit with Hyatt's Motion for a Protective Order to Seal the File.[4]

B. Despite internal FTB dissent regarding whether it even had a tax case against Hyatt, the FTB asserted a fraud penalty against Hyatt.

The FTB uses fraud penalties to bargain with and coerce taxpayers into settling tax disputes. In seminars, the FTB teaches its auditors that penalty assessments are like poker chips to be traded for a settlement.[5] The FTB also uses the sinister "skull-and-crossbones" symbol when teaching auditors about penalty assessments.[6] Shortly following the FTB's proposed assessment of a significant fraud penalty as set forth the Notice of Proposed Assessment dated April 23, 1996 and based on the bogus grounds that Hyatt did not cooperate in the audits,[7] FTB protest

[4] *See* protest letter (attached as Exhibit I to the Kula Declaration submitted with the Motion for a Protective Order to Seal the File)

[5] C. Les. Depo., 226-28, 674-78, 684-87; D. Dick Depo., 87-91, 215-17; C Ford Depo., 128-130; and H 08950-08972, all attached as part of Exh. M to the Kula Decl.

[6] H 08950, attached as Exh. N to the Kula Decl.

[7] *See* Exhibits to Bauche Decl., submitted by FTB in support of its petition.

officer Anna Jovanovich boldly suggested, as described in more detail below, that Hyatt settle the tax dispute or else risk his private information becoming public.

The FTB's assessment of a fraud penalty was made despite internal FTB records (produced in the Nevada case only after the FTB had been denied a writ by the Nevada Supreme Court) that document that the FTB team reviewing the Hyatt 1991 audit (including the lead auditor) concluded that the FTB did not have a "sourcing" case at all or a "residency" case for 1992 against Hyatt,[8] and that even the "reviewer" questioned whether the FTB had any "residency" case against him. The "reviewer" concluded that Hyatt appeared to be a Nevada resident by no later than late 1991, many months before the April 1992 date asserted in the FTB's NPAs for the 1991 and 1992 tax years.[9]

Moreover, one FTB auditor who worked with the lead auditor, openly complained about the conduct of the lead auditor, including that she was obsessed with and "out to get" Hyatt. During her deposition in the Nevada tort case, this auditor testified extensively about the abuse and misconduct directed at Hyatt by the lead auditor.[10]

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[8] Kula Decl., para. 19

[9] Kula Decl, para. 18

[10] C. Les Depo., p. 10-21, attached as Exh. L. to the Kula Decl.

C. The FTB once again falsely asserts that Hyatt did not cooperate in the audits.

A basis for the FTB to assert a fraud penalty is lack of cooperation by the taxpayer. The Bauche declaration submitted by the FTB asserts that Hyatt did not cooperate in the audits. But she does not provide any foundation for her statement made under oath. Instead, Bauche has admitted that she had no knowledge of nor involvement in the audits.[11] She therefore lacks proper first hand knowledge to comment about the audits.

In truth, Hyatt and his professionals promptly responded to all requests from the FTB auditors and produced thousands of pages of documentation to the FTB for the relevant time period in the tax proceedings.[12] Hyatt produced every document in his possession that was requested by the FTB during the tax proceedings, and Hyatt has documented his cooperation in the tax proceedings.[13] The FTB's lead auditor also testified that Hyatt's accountant and tax attorney acted professionally throughout the audits.[14] The bogus non-cooperation claim was made, and continues to be made, by the FTB as a disingenuous attempt to justify its misconduct.

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[11] Bauche Depo., 62, 170-71, 385-386, attached as Exh. E to the Kula Decl.

[12] Kula Decl., paras. 6-9, Exh. C.

[13] *See* Section II. F. 4 (pages 129-130 of the letter) of the Protest letter (attached as Exhibit I to Kula Declaration submitted with Hyatt's Motion for a Protective Order to Seal the File).

[14] S. Cox Depo., 80-81, 726-27, 729 and 731 attached as Exh. D to the Kula Decl.

D. The FTB's large investment in the Hyatt audits caused the FTB to assess Hyatt a significant amount, regardless of whether it was warranted or could ever be collected.

Hyatt contends that FTB auditors and supervisors were motivated, even required, to assess him significant taxes and penalties due to the time incurred in auditing him and the pressure imposed on the FTB auditors to return a profitable "CBR" or Cost Benefit Ratio. FTB witnesses testified in the Nevada case about this CBR.[15] The evidence established that the FTB's auditors recorded 624 hours on the Hyatt 1991 tax-year audit and 1991 tax-year Progress Report, even though the typical audit takes between 100-200 hours.[16] The FTB lead auditor, being evaluated by the CBR method, was consequently motivated to make a significant assessment against Hyatt to justify this extraordinary amount of audit time, regardless of the strength and foundation of the assessment since auditors are evaluated by dollars assessed, not dollars collected.

[15] *See* Deposition of Candace Les, 1, 152-155, 209-211; Deposition of Steve Illia, 80-83, 276-278, 335; Deposition of Jeffrey McKenney, 76-77; Deposition of Sheila Cox, 1916-17; Deposition of Carol Ford, 153-154; Deposition of Monica Embry, 201-202; and Deposition of Allan Shigemitsu, 42-43, all of which are attached as Exh. O to the Kula Decl.

[16] FTB 03477 (also H 08657), attached as Exh. P to the Kula Decl.

E. The Nevada tort case has a very different focus: tortious misconduct by the FTB from 1993 to the present and an attempt by the FTB to coerce a settlement from Hyatt.

Hyatt's Nevada tort claims stem from the FTB's still ongoing almost 10 year investigation, surveillance and audit of Hyatt. But the tort claims, and the discovery related thereto, are focused on the conduct of the FTB during the tax proceedings commenced against Hyatt in mid-1993. In sum, the tax proceedings relate to Hyatt's residency from September 1991 to April 1992, but the tort case relates to the FTB's conduct from mid-1993 to the present.[17]

Specifically in regard to Hyatt's tort claims, he alleges among other things, invasion of his privacy and disclosure, and threatened additional disclosures, of his "taxpayer" information, fraud and extortion based on the threatened disclosure of confidential information and various related torts. Hyatt's motion to seal the file discussed in more detail his invasion of privacy claims.[18]

More relevant here are Hyatt's claims stemming from the FTB's attempt to extort a settlement. The evidence establishes that the FTB's first protest officer, Anna Jovanovich, boldly "suggested" to Hyatt's tax attorney shortly after the "protest stage" of the tax proceedings

[17] *See* Hyatt's Motion for a Protective Order to Seal the File, at 3-6, for a more detailed discussion of Hyatt's claims in the Nevada tort case; *see also* Hyatt's Petition for Rehearing filed in the Nevada tort case (attached as Exhibit A to Kula Declaration submitted with Hyatt's Motion for a Protective Order to Seal the File).

[18] *Id.*

commenced in 1996 that Hyatt settle the matter to avoid Hyatt's personal and financial information being made public. Specifically, she told Hyatt's tax attorney that it would be necessary for the FTB to engage in extensive additional requests for information from Hyatt as that is its practice "in high profile, large dollar" residency audits. In fact, Ms. Jovanovich testified that she told Hyatt's tax representative that in such cases the FTB will conduct an in-depth investigation and exploration "*of many **unrelated** facts and questions*" concerning Hyatt.[19]

F. The Nevada court issued a standard protective order to protect from public disclosure the confidential information produced in that case.

In the Nevada tort case, and as foretold by Jovanovich, the FTB sought a wide range of confidential and private information from Hyatt, ostensibly to defend against Hyatt's claims. The discovery requested by the FTB included Hyatt's confidential business records and personal financial information for time periods well beyond that at issue in the tax proceeding. It also included requests to enter, inspect and videotape Hyatt's *current* residence and business, as well as the home of one or more of his business associates.[20] Not surprisingly, Hyatt sought a protective order that allowed production of the

[19] Jovanovich depo., Vol. I, pp. 50-52, 168, 185-186 (emphasis added), attached as Exh. F to the Kula Decl.

[20] Kula Decl., para. 11.

potentially relevant information in the tort case, but also limited its use to that case.[21]

G. The FTB understands that the Nevada protective order is limited.

The FTB would have this Court believe that the Nevada protective order applies to every document in the Nevada tort case. In a motion seeking to vacate the protective order, the Nevada court denied that motion and confirmed that the protective order applies to only a small subset of documents that have been specially designated "Confidential – NV Protective Order."[22] Moreover, the protective order itself is clear that only documents affirmatively stamped "Confidential – NV Protective Order" by a party are designated under, and subject to, the order. Correspondence regarding the drafting of the protective order also confirmed the need to stamp documents with the special designation.[23]

Indeed the declaration of Robert Dunn submitted with the FTB's petition acknowledges the distinction that some documents are designated under the protective order, while most of the documents in the Nevada case are

[21] Kula Decl., paras. 10, 12-15, *see also* copy of the Nevada protective order attached as Exh. F to the Declaration Robert W. Dunn submitted with the FTB's petition.

[22] Transcript from January 17, 2002 hearing, pp. 21, attached to the Kula Decl.; *see also* Hyatt Opposition to FTB's Motion to Vacate Protective Order, pp. 7-11 and 15-18, attached as Exh. O to the Kula Decl.

[23] D. Kula letter dated November 22, 1999; J. Steffen letter dated December 14, 1999, both attached as Exh. H to the Kula Decl.

merely stamped "Confidential."[24] Finally, the FTB has designated select materials as "Confidential – NV Protective Order."[25] The FTB therefore understood, and still understands, the special designation needed for documents to be designated under the protective order. The FTB's current argument that the whole case file may be subject to the protective order is disingenuous.

H. The FTB ignored Hyatt's requests to clarify and focus the subpoena.

In June of this year –after losing the motion to vacate referenced above and prior to issuing the administrative subpoena – the FTB's lead Nevada counsel, Felix Leatherwood, Esq., sent a written request to one of Hyatt's Nevada counsel, Mark Hutchison, Esq., asking that Hyatt allow all material designated by Hyatt under the Nevada protective order to be submitted in the tax proceedings. Mr. Hutchison responded by seeking clarification and specification of the documents requested and also asking if the FTB would agree to keep confidential and not publicly disclose any information produced under the protective order and submitted to the tax proceedings.[26] The FTB did not respond, other than to issue the administrative subpoena.

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[24] *See* Declaration of Robert Dunn, para. 4, submitted with FTB's petition.

[25] Kula Decl., paras. 17-20.

[26] M. Hutchison letter, dated June 10, 2002, attached as Exh. C to declaration of Robert Dunn submitted with the FTB petition.

In July of this year, in response to the administrative subpoena, Hyatt's lead counsel in the tax proceedings, Eric Coffill, Esq., sent a written response to the subpoena seeking clarification regarding the six categories listed in the subpoena and specification regarding which of the documents designated under the protective order the FTB was seeking. Mr. Coffill's letter also stated a relevancy objection to the subpoena citing the limited nature of the dispute in the tax proceedings.[27] The FTB did not respond to Mr. Coffill's letter.

IV. Legal argument.

A. California law and the Fourth Amendment require that administrative subpoenas seek only relevant information and not be too indefinite.

The FTB's petition acknowledges that an administrative subpoena must seek information reasonably relevant to the underlying proceeding and not be too indefinite. More specifically, the FTB's specific subpoena power under Section 19504 of the Revenue and Taxation Code provides that the information must be "relevant" to "ascertaining the correctness of [taxpayer's return]. . . . " Information sought through administrative subpoenas in general must be "*pertinent or material* to any inquiry, investigation, hearing, proceeding, or action conducted in any part of the state."[28]

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[27] E. Coffill letter, dated July 22, 2002, attached as Exh. A to declaration of Benjamin F. Miller submitted with the FTB petition.

[28] Cal. Gov't Code § 11181(e).

In addition, the California Supreme Court has established guidelines defining the permissible reach of an administrative subpoena duces tecum issued under Government Code section 11181. In *Brovelli v. Sup. Ct.*,[29] the California Supreme Court explained that department heads cannot compel production of evidence in disregard of constitutional rights and safeguards. The Court stated that:

> Insofar as the prohibition against unreasonable searches and seizures can be said to apply at all requires only that the inquiry be one which the agency demanding production is authorized to make, that the demand be not too indefinite, and that the information sought be reasonably relevant.[30]

In short, administrative subpoenas cannot violate the United States Constitution's Fourth Amendment prohibition on illegal searches and seizures.[31]

B. An administrative subpoena will not be enforced if it intrudes on an individual's constitutional privacy rights.

In *Board of Medical Quality Assurance v. Gherardini*,[32] the court held that the constitutional right to privacy safeguards an individual from government data

[29] 56 Cal.2d 524, 529 (1961).

[30] *Id.*

[31] *Craib v. Bulmash*, 49 Cal. 3d 475, 484 (1989).

[32] *Board of Medical Quality Assurance v. Gherardini, supra*, 93 Cal.App.3d 669.

gathering, absent a showing of waiver or good cause. "The state of a person's gastro-intestinal tract is as much entitled to privacy from unauthorized public or bureaucratic snooping as is that person's bank account, the contents of his library or his membership in the NAACP."[33]

Citing to *White v. Davis*[34] and other California Supreme Court precedent,[35] the *Gherardini* court condemned "Government agencies [that] seem to be competing to compile the most extensive sets of dossiers of American citizens." It condemned the "[c]omputerization of records [that] makes it possible to create 'cradle-to-grave' profiles of every American."[36]

Gherardini held that administrative agencies are not in any "special or privileged category, exempt from the right of privacy requirements, which must be met and honored generally by law enforcement officials."[37] To hold any differently would ignore the federal and state constitutional commands. While agencies have unquestioned rights to investigate, they cannot ignore individuals' "constitutional and statutory rights to be left alone."[38] That right includes, at a minimum, "one's confidential

[33] *Id.* at 679.

[34] 13 Cal. 3d 757, 775 (1975), modified by *Hill v. NCAA*, 7 Cal. 4th 1, 34-35 (1994)

[35] *Gherardini, supra*, at 677-78, citing *People v. Privitera*, 23 Cal. 3d 697, 709 (1979)

[36] *Id.*, citing *Privitera* at 709.

[37] *Id.* at 679-80.

[38] *Id.* at 680.

financial affairs as well as to the details of one's personal life."[39]

Gherardini imposed requirements far beyond mere relevance. It held that:

> Beyond the showing of relevance, materiality to the investigation, *it is encumbent on the Medical Board to show that the patient's constitutional rights are not infringed.* If disclosure is to be compelled after the requisite balancing of the juxtaposed rights, and the finding of a compelling state interest, then it should be accomplished *only by an order drawn with narrow specificity*. By interposition of such minimal due process requirements the mandate of *Katz v. United States*, [citation]; *Griswold v. Connecticut*, [citation], and article I, section 1, of the California Constitution will be fulfilled and Evidence Code Section 1007 held constitutional. Only by such procedure may the requisite balancing of the private and the state interest be effected.[40]

In this matter, the FTB seeks, on the face of its subpoena, a massively overbroad amount of documents: "All" materials from the Nevada tort case. As explained further below, the FTB makes no attempt to explain how or why it needs this information in the tax case, particularly when the tax case, is in effect, concluded.

[39] *Id.* at 680, citing and quoting from *Valley Bank of Nevada v. Superior Court (Barkett)*, 15 Cal. 3d 652, 656 (1975).

[40] *Id.* at 681-82.

In that regard, under the holding in *Wood v. Superior Court, (Board of Medical Quality Assurance)*,[41] the FTB has failed to even submit the necessary declarations establishing the need for the requested information in the tax proceedings. *Wood* relied upon *Gherardini* and required the Attorney General to show that the stage agency had no alternative means of securing its legitimate objectives. It required the agency to show that no less intrusive measures could be devised to avoid or minimize the conflict with privacy.[42] It reasoned that since the Board was only interested in evidence of wrongdoing, it had to narrowly tailor the subpoena to winnow out records that were irrelevant and immaterial to the propriety of the prescriptions.[43] The Court of Appeals held that absent the particularized showing, the Superior Court has no means by which to gauge the likelihood that the records sought will reveal misconduct. "Without this there can be no independent judicial assessment of good cause. The *judicial* function of assessing cause cannot be abdicated by deferring to the bare conclusions of board personnel."[44]

C. The FTB makes no showing of the need for the unidentified documents.

The FTB cannot demonstrate the relevancy of its subpoena requests, nor can it state with precision the

[41] *Wood v. Superior Court, (Board of Medical Quality Assurance)*, 166 Cal. App. 3d 1138 (1985).

[42] *Id.* at 1148.

[43] *Id.* at 1148-49.

[44] *Id.* (emphasis in original, citation to 8 *Wigmore on Evidence* § 2195 (McNaughton rev. ed. 1961) omitted).

documents that it seeks. While not presented in this Court, in the FTB's motion to vacate the protective order in the Nevada case, the FTB provided its only explanation as to why certain of the documents designated under the protective order were requested for the tax proceedings, including the deposition transcript of Mike Kern referenced in the subpoena.

The FTB cited its desire to use the Kern deposition transcript relating to Hyatt's stay at the Continental Hotel during September and October of 1991. The FTB claimed it needed this information in the tax proceeding.[45] What the FTB does not tell the Court is that, in the tax proceeding, Hyatt has already submitted the relevant information that he has regarding his stay at the Continental Hotel, including his statement of the exact dates he stayed there.[46] Further, Hyatt did not meet Mr. Kern until long after the time of Hyatt's stay at the Continental Hotel. Mr. Kern's brief testimony during his deposition in this case was simply about his 1996 inquiry seeking information and documents from the Continental Hotel.

In its motion to vacate the protective order, the FTB also cited to licensing agreements entered into by Hyatt. But Hyatt long ago produced to the FTB all the licensing agreements relevant to the time period at issue in the tax proceedings between late September 1991 and early April 1992.[47] To the extent the FTB desires to use licensing

[45] Kula Decl., para. 15, Exh. I (*see* pp. 10-11 thereto).

[46] *See* Protest letter attached to prior Kula declaration (Exhibit I thereto, p. 12 of the Protest letter) filed in Support of Hyatt's Motion for a Protective Order to Seal the File.

[47] Kula Decl., para. 15, Exh. I (*see* pp. 10-11 thereto).

agreements for the subsequent years in the tax proceeding, the FTB gives no explanation why or how they are relevant to the tax proceedings.

Finally, a significant number of the documents designated by Hyatt under the Nevada protective order were in fact voluntarily produced to the FTB in the audits and protests.[48] Hyatt's designation of those documents under the Nevada protective order does not therefore prohibit their use in the audits and protests. This too was made clear in the protective order[49] and confirmed later when the FTB moved to vacate the protective order.[50]

In sum, the documents designated by Hyatt under the protective order are made up either of documents that are irrelevant (e.g., outside of the six month disputed residency period) or documents that Hyatt has already produced to the FTB (e.g., license agreements that were signed within the disputed period). The FTB has made no attempt here, nor in response to Hyatt's request to meet and confer, to explain why it needs any of the material that have been designated under the Nevada protective order *that it has not already received directly in the audits or protests*, or for that matter any of the materials filed under seal in Nevada or any of the privileged material Hyatt properly withheld in the Nevada tort case. This is

[48] Kula Decl., paras. 6-9.

[49] *See* Nevada Protective Order, para. 11, attached to the Declaration of Robert Dunn submitted with the FTB's petition.

[50] Transcript from January 17, 2002 hearing, pp. 21-24, attached as Exh. J to the Kula Decl.; *see also* Hyatt Opposition to FTB's Motion to Vacate Protective Order, pp. 7-11, 15-18, attached as Exh. I to Kula Decl.

despite the fact that the FTB submitted with its petition declarations from two of the attorneys intimately involved with the Nevada tort case (Felix Leatherwood, Esq., Robert Dunn, Esq.,). Each is familiar with all materials filed and produced in the Nevada tort case, but neither provides a description of the particular documents that may be relevant to the tax proceedings. It can therefore be inferred that there are no additional documents not already in the FTB protest officer's possession that were designated under the Nevada protective order, or otherwise first obtained by the FTB in the Nevada tort case, relevant to the tax proceedings.

D. Enforcement of the FTB's subpoena would be an abuse of process.

1. Courts will not enforce bad faith subpoenas, i.e. those issued for an ulterior purpose and intended to intimidate or coerce a settlement.

In *United States v. Powell*,[51] the United States Supreme Court upheld an IRS subpoena over a bad faith challenge, but stated it would refuse to enforce a subpoena where there was an abuse of process based on the bad faith of the agency in issuing the subpoena. The Court gave this example:

> It is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused. Such an abuse would take place if the summons had been

[51] *United States v. Powell*, 379 U.S. 48 (1964).

> issued for an improper purpose, such as to harass the taxpayer *or to put pressure on him to settle a collateral dispute*, or for any other purpose reflecting on the good faith of the particular investigation. The burden of showing an abuse of the court's process is on the taxpayer. . . .[52]

Hyatt has set forth in detail in this opposition, his motion to seal the file, and his initial *ex parte* application the FTB's attempts to intimidate and coerce him into a settlement through threats of disclosing his confidential information. Given the lack of relevance to the tax proceedings of the documents protected under the Nevada protective order, the refusal of the FTB to respond to Hyatt's requests for clarification of the requested documents, and the FTB's conduct in this case in filing Hyatt's tax information in open court and vigorously opposing Hyatt's request to seal the file, an obvious inference is that the FTB is still trying to intimidate and coerce Hyatt by issuing the subpoena and seeking irrelevant documents (as Ms. Jovanovich promised to do should Hyatt choose not to settle). The FTB's petitions should therefore be denied.

2. In addition to intimidation and coercion, the FTB seeks enforcement of the subpoena to negate the protections accorded Hyatt under the Nevada protective order.

Two the of the declarations submitted by the FTB in support of its petition are from attorneys involved in the

[52] *Id.*, at 58 (emphasis added and footnote omitted).

Nevada tort case (Felix Leatherwood, Esq., and Robert Dunn, Esq.,). Again, each is well acquainted with the documents Hyatt has designated under the Nevada protective order and could have provided insight into why the FTB believes they may be relevant to the tax proceedings. The FTB could have issued and sought enforcement of a limited subpoena that specifies the documents needed in the tax proceedings. The FTB chose not to do so.

Instead, the FTB seeks a blanket order allowing use of all discovery materials from the Nevada case in the tax proceedings. The FTB does not want to be constrained by the Nevada protective order, even with regard to documents irrelevant to the tax proceedings, and it asks this Court to give it authority to disregard the Nevada protective order. In that regard, the FTB's failed attempts to vacate the Nevada protective order in Nevada were described above. There is no escaping the conclusion that the FTB wants to eliminate the Nevada protective order so that it has free reign to make Hyatt's confidential documents public as it threatened to do. This is an improper purpose for the relief sought by the FTB from this Court.

In that regard, the FTB's lead counsel in the Nevada tort case, Mr. Leatherwood, has routinely expressed open contempt for the Nevada court and his threatened to seek review of its orders in California Superior Court.[53] But that is not the function of this Court, nor can it be under the Full Faith and Credit Clause of the United States Constitution.[54] Under the Full Faith and Credit Clause,

[53] *See* Kula Decl., para. 21 and Exh. K thereto.

[54] U.S. Const. Art. IV, Sec. I.

the Nevada protective order is entitled to all the respect and solemnity of any other judicial ruling from a sister state or another California court, despite Mr. Leatherwood's expressed contempt for the order and the Nevada court.

V. Conclusion.

The FTB has not and cannot establish that "all" of the material from the Nevada tort case is relevant to the tax proceedings. The FTB also fail to identify and describe the documents it seeks to compel Hyatt to produce. The petition, as well as the subpoena, manifest the threats previously made by the FTB and constitute an abuse of process. For all these reasons, Hyatt respectfully requests that the Court deny the FTB's petition.

DATED: November 26, 2002

RIORDAN & McKINZIE
A Professional Law Corporation

By: /s/ Donald J. Kula
Donald J. Kula
Attorneys for Respondent
GILBERT P. HYATT

PROOF OF SERVICE BY EXPRESS MAIL OR OTHER EXPRESS SERVICE

STATE OF CALIFORNIA COUNTY OF LOS ANGELES

I am employed in the county aforesaid; I am over the age of 18 years and not a party to the within action; my business address is 300 South Grand Avenue 29th Floor, Los Angeles, CA 90071-3109.

On November 26, 2002, I served the foregoing document(s) described as **RESPONDENT GILBERT P. HYATT'S RESPONSE AND OPPOSITION TO THE OSC RE FTB'S PETITION FOR ORDER TO COMPEL COMPLIANCE WITH ADMINISTRATIVE SUBPOENA** on interested parties in this action by placing a true copy thereof in a sealed envelope or other package designated by the express service carrier, at Los Angeles, California, addressed and numbered as follows:

Molly Mosley, Esq.
Attorney General
Department of Justice
1300 I Street, Suite 125
Sacramento, CA 95814

I am readily familiar with this firm's practice of collection and processing correspondence for mailing and overnight delivery. Under that practice, it would be deposited on that same day in the ordinary course of business at Los Angeles, California,

Executed on November 26, 2002, at Los Angeles, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

/s/ Sophia Thompson
Sophia Thompson